

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Davis Analyst: Jeani Brent Bill Number: AB 482

Related Bills: AB 1752 (1998) Telephone: 845-3410 Introduced Date: 02/18/1999

Attorney: Doug Bramhall Sponsor: _____

SUBJECT: California Seed Capital and Early Stage Corporation Fund Credit

SUMMARY

Under the Corporations Code, this bill would establish the California Seed Capital and Early Stage Corporation (the corporation) to mobilize investment in private seed and venture capital partnerships or entities through a single designated for-profit investment fund.

Under the Revenue and Taxation Code, this bill would allow taxpayers to claim credits against their insurance gross premium, personal income, or bank and corporation tax, as certified by the corporation, for any shortfalls that occur in the scheduled or actual returns to investors.

The Revenue and Taxation Code provisions relating to the insurance gross premium tax credit is not discussed in this analysis because that tax is not administered by the department. The Corporations Code provisions relating to the creation of the corporation are discussed only to the extent they apply to the income tax credits.

EFFECTIVE DATE

This bill would become effective January 1, 2000, and the bill specifies that the credit would apply to taxable or income years beginning on or after January 1, 2000, and before January 1, 2026.

PROGRAM HISTORY/BACKGROUND

Information in this section is from Business Capital Needs in California: Designing a Program, by Gus Koehler, Ph.D. and Rosa Maria Moller, Ph.D., a report developed by the California Research Bureau, California State Library, April 1998.

"During the last two decades, several states have created state-sponsored venture capital programs to provide financing for new and small business. Venture capital programs are public sector activities that mimic or work with venture capitalists to provide capital for companies in a development state.

"All of these state programs involve at least an initial contribution of money by the state for business capital investment purposes. The programs can then be divided into two main categories:

- "Public-private funds are principally privately managed.

Board Position:

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Department Director

Date

Gerald Goldberg

4/8/1999

The state contributes initial capital, although it is usually matched by private investments and sometimes by pension fund investments. The state often sets some criteria for selecting companies in which investments will be made. . . .

- "Publicly run venture capital programs have a larger public role in their management.

"Funds to establish these programs have come from several sources. Most states directly appropriated some initial capital. A few states were able to supplement that with federal grants. Most programs are revolving funds, and are allowed to reuse repayments of investments made. Connecticut's program began with \$10 million in general obligation bond proceeds. Oregon's program uses lottery proceeds. Michigan used a state loan from oil and gas royalties, and more recently gaming revenues. Oklahoma found a remarkably innovative way to use tax credits to fund its programs. The legislature gave the program \$50 million in tax credits. The program uses those tax credits to guarantee loans made at its direction by institutional investors (banks, mostly). If a loan fails, the program sells tax credits sufficient to make good on the institutional investor's loan. So far, Oklahoma has used this device to raise over \$20 million, and has not had to sell any tax credits."

SPECIFIC FINDINGS

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., child and dependent care credits) or to influence behavior, including business practices and decisions (e.g., research credits).

Under existing state and federal laws, generally tax credits may be claimed only by the taxpayer that incurred the credit-related expense. In the case of the low-income housing credit, if a property is acquired during the credit period, the credit may be transferred to the acquiring taxpayer. In addition, the low-income housing credit may be transferred between wholly-owned affiliated corporations.

This bill would allow taxpayers to claim credits against their personal income or bank and corporation tax, as certified by the corporation, for any shortfalls that occur in the scheduled or actual returns to investors in the California Seed Capital and Early Stage Corporation Fund of invested capital. The credits are to be sufficient to support the raising of \$100 million of investment capital.

The bill states that the corporation shall certify the amount of tax credits that are to be allowed to investors and the years those tax credits may first be claimed. The corporation would be required to obtain the taxpayer identification numbers of the investors and provide an annual listing to the department. Taxpayers would be required to keep a copy of their certification and provide it to the department upon request. The bill provides that the credits may be assigned to affiliated corporations, as provided.

The California Constitution provides that the power to tax may not be surrendered or suspended by grant or contract.

Policy Considerations

Generally, tax credits are allowed to the taxpayer that incurred the related expense. Under state law, only the low-income housing credit contains a provision to allow the credit to be assigned, which allows transfer of the credit only to the purchaser of the property or between affiliated corporations as long as the affiliation is 100% ownership. This bill would allow the credit to be assigned to affiliated corporations.

Credits generally are enacted with parameters on the amount of credit allowed to each taxpayer and/or on the aggregate total amount of tax credits that may be allocated. While private corporations may be delegated the authority to allocate the credits, this allocation may not exceed the amounts provided in the law. This credit, however, would allow the amount of credit for each taxpayer and the total amount of credit for all taxpayers to be determined solely by the contract between the corporation and the investors. Providing the corporation the power to determine the parameters of the tax credit provided in this bill could be viewed as effectively appropriating general fund revenues and thus might be considered an unconstitutional delegation.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the department's normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

The amount of capital taxpayers invest in the fund, the scheduled rate of return, whether actual rates of return fall short of scheduled returns, and the amount of credits, if any, that could be applied to reduce tax liabilities of investors would determine the revenue impact of this bill. It is not known how the fund might fare or what the scheduled return might be.

Although a revenue impact cannot be projected, the risk of loss is significant. For example, if the investment fund were to accumulate the \$100 million target at a scheduled rate of return of 10%, but only realize a return of half that, the shortfall would be \$5 million [\$10 million scheduled return versus \$5 million realized return). Under the Bank and Corporation Tax Law, any certified credits could be assigned to one or more members of a commonly controlled group. Potentially this could result in 100% usage of credits in the year certified.

BOARD POSITION

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill.